

## Message Text

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ACTION EB-03

INFO OCT-01 NEA-07 EUR-08 ISO-00 SS-14 INR-05 SP-02 H-01

L-01 PM-03 OES-02 PRS-01 SAM-01 /049 W

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R 120810Z MAR 76

FM AMEMBASSY TEHRAN

TO SECSTATE WASHDC 6006

INFO AMEMBASSY JIDDA

AMEMBASSY LONDON

AMEMBASSY PARIS

C O N F I D E N T I A L SECTION 1 OF 2 TEHRAN 2579

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EO 11652: XGDS-1

TAGS: ENRG, PFOR, IR, UK, FR

SUB: NIOC/CONSORTIUM RELATIONS

REF: LONDON 3781

1. SUMMARY: OIL COMPANY CHIEF EXECUTIVES (BP, TEXACO, SOCAL AND POSSIBLY SHELL) MET MARCH 11 WITH NIOC CHAIRMAN EGHBAL AND HIS AIDES TO EXPLORE WHETHER SOME BASIS MAY EXIST FOR BREAKING THE PRESENT DEADLOCK AND WHETHER THERE IS ANY POINT IN THEIR HAVING AN AUDIENCE WITH THE SHAH. SITUATION IS TENSE AND COULD INDEED END IN BREAKUP OF CONSORTIUM. NATIONALIST AND ANTI-US COMPANY FEELING IS RUNNING HIGH AMONG MANY MEMBERS OF NIOC NEGOTIATING TEAM. ISSUES FOR THE US COMPANIES RUN FAR DEEPER THAN "FEW CENTS" PROFIT MENTIONED BY UK FONSEC CALLAGHAN, REPORTED REFTEL. WE AGREE WITH EMBASSY LONDON IN DOUBTING ADVISABILITY OF USG'S "GETTING IN MIDDLE" OF COMPANY DISPUTES, THOUGH WE WOULD HESITATE TO SAY IT WAS SIMPLY REDUCED LIFTINGS BY US FIRMS THAT "LED TO" PRICE REDUCTION ON IRANIAN HEAVY. EMBASSY ANTICIPATES AT LEAST ONE FURTHER BRIEFING FROM COMPANY EXECUTIVES BEFORE THEIR DEPARTURE FROM TEHRAN (THEY HAVE MEETINGS SCHEDULED MARCH 13 AND MAY HAVE  
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LATER ONES). WE WILL REPORT FUTURE BRIEFINGS AS THEY OCCUR AND

WILL SUGGEST TO COMPANIES THAT THEY BRIEF DEPARTMENT ON THEIR RETURN AS WELL. END SUMMARY.

2. CONSORTIUM MEMBER CHIEF EXECUTIVES MET WITH DR. EGHBAL AND HIS STAFF FOR ALMOST THREE HOURS MARCH 11, AN APPARENTLY ENCOURAGING SIGN. ATMOSPHERE PRECEDING MEETING HAS BEEN ONE OF SHARP CONFRONTATION, AND US COMPANIES, OF COURSE, ARE THE MAIN VILLAINS. AT PRESENT, PERHAPS EVEN MORE THAN IN PAST, US COMPANIES BELIEVE THEY HAVE SPECIAL PROBLEMS THAT RENDER THEM UNABLE TO ACCEPT CERTAIN FEATURES OF AN AGREEMENT WITH WHICH SOME OR ALL OF THE EUROPEAN COMPANIES WOULD HAVE LITTLE DIFFICULTY. WORRIES ABOUT SETTING PRECEDENTS IN ONE COUNTRY THAT COULD CAUSE PROBLEMS ELSEWHERE ARE NOW EMPHATICALLY OR MORE CONCERN TO US COMPANIES THAN TO THE EUROPEANS, WHO AT PRESENT SEEM TO HAVE LITTLE TO WORRY ABOUT OTHER THAN THE MODEST REMNANTS (ADPC, QPC) OF THE OLD IPC EMPIRE. THE ARAMCO PARTNERS, HOWEVER, APPEAR TO BE AT A PARTICULARLY SENSITIVE STAGE IN TALKS WITH SAG AND WILL CERTAINLY DO NOTHING HERE AND NOW THAT COULD COMPLICATE THE PROBLEMS OF REACHING AN ACCEPTABLE AGREEMENT ON THEIR FUTURE IN SAUDI ARABIA. FURTHER, THE US COMPANIES FACE POTENTIAL PROBLEMS WITH US TAX AND ANTI-TRUST LAWS OF A KIND THAT MOST EUROPEAN COMPANIES DO NOT ENCOUNTER. (BP REP, FOR EXAMPLE, SAID UK TAX LAWS ARE SUFFICIENTLY FLEXIBLE THAT BP CAN TO LARGE EXTENT NEGOTIATE ITS TAX TREATMENT.)

3. FURTHER, THE PROBLEM OF LOW LIFTINGS OF HEAVY CRUDES IS NOT ONE THAT CAN EASILY BE SOLVED BY ADJUSTMENTS IN PRICE DIFFERENTIALS OR BY THE COMPANIES' DECIDING TO IGNORE "A FEW CENTS LESS PROFIT" AND TO LIFT MORE IRANIAN HEAVY. THE UNDERLYING PROBLEM CONTINUES TO BE A SHIFT IN MARKET DEMAND TOWARD A LARGER PROPORTION OF LIGHTER PRODUCTS. GIVEN THAT THERE IS A PHYSICAL LIMIT (AT LEAST IN THE SHORT TO MEDIUM TERM) ON THE ABILITY OF REFINERIES TO TURN HEAVY CRUDES INTO LIGHT PRODUCTS, THE ONLY CHOICE REFINERS HAVE IS TO TURN TO LIGHTER CRUDES. THUS OVER THE LAST FEW MONTHS PRODUCTION OF IRANIAN LIGHT HAS BEEN NEAR CAPACITY, WHILE THAT OF HEAVY HAS BEEN DOWN BY AROUND 50 PERCENT. PRODUCTION OF ARABIAN LIGHT APPEARS TO BE HIGH. WE WOULD GUESS THAT THE MARKETS OF THE US COMPANIES (POSSIBLY EXCLUDING GULF), ON THE AVERAGE INCLINE MORE TO LIGHTER

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PRODUCTS THAN DO THE EUROPEANS' MARKETS. THUS IT WOULD SEEM NATURAL AND PERHAPS NECESSARY (IN TERMS OF SUPPLYING THEIR EXISTING MARKETS) FOR US COMPANIES TO LIFT ARABIAN LIGHT RATHER THAN IRANIAN HEAVY, WHICH SEEMS TO BE WHAT IS HAPPENING.

4. WE HAVE LITTLE GRASP HERE OF THE NATURE OF THE US COMPANIES' POTENTIAL ANTI-TRUST DIFFICULTIES THAT COULD ARISE FROM A NEW

AGREEMENT, BUT GATHER THEY NEED SOME SORT OF LANGUAGE THAT INDICATES THE CONTINUITY OF ANY NEW AGREEMENT WITH THE 1973 AND 1954 AGREEMENTS, AND THUS PRESERVES THE PROTECTION GIVEN BY A 1954 BUSINESS REVIEW LETTER. THE MOST SERIOUS PROBLEMS, HOWEVER, SEEM TO ARISE FROM US TAX LAW. THE BASIC PROBLEM IS THAT IF THE US COMPANIES DO NOT RETAIN A TAX CREDIT, THEIR ALREADY PAPER-THIN MARGINS ON IRANIAN CRUDE WILL BE APPROXIMATELY HALVED. THIS WOULD PUT THEM AT A DISADVANTAGE RELATIVE TO THEIR EUROPEAN COMPETITORS AND TO NOC'S, AND WOULD CONSTITUTE A PERMANENT DIS-INCENTIVE TO LIFT IRANIAN CRUDE. THERE MAY BE BASICALLY TWO MECHANISMS, AS WE UNDERSTAND THE CASE, BY MEANS OF WHICH US COMPANIES MIGHT RETAIN TAX CREDITS ON THEIR IRANIAN OPERATIONS. (A) ONE, APPARENTLY, WOULD BE THE "VENEZUELAN MODEL" MENTIONED IN REFTEL. UNDER THIS MODEL THE CONSORTIUM MEMBERS, SEVERALLY OR IN A JOINT COMPANY, WOULD HAVE A SERVICE COMPANY OR COMPANIES IN IRAN, WHICH WOULD PROVIDE TECHNICAL/MANAGERIAL SERVICES FOR A FEE ON EACH BARREL PRODUCED REPEATE PRODUCED. THESE FOREIGN-OWNED IRANIAN COMPANIES WOULD THEN MAKE PROFITS IN IRAN (LIKE ANY CONSULTING FIRM), ON WHICH THEY WOULD PAY IRANIAN TAXES, FOR WHICH THEY WOULD GET U.S. TAX CREDITS. (THE FEE WOULD HAVE TO BE "GROSSED UP" TO LEAVE THE COMPANIES WITH THE AGREED FEE, NET OF IRANIAN TAXES.) THE PROBLEM IS THAT THE IRANIANS, FOLLOWING THEIR USUAL PRACTICE OF "SHOPPING" FOR THE BEST ELEMENTS IN VARIOUS AGREEMENTS, WILL NOT STICK WITH THE "VENEZUELAN MODEL" ALL THE WAY: NIOC DEMANDS THAT THE FEE BE PAID ON MEMBERS' LIFTINGS, NOT ON PRODUCTION. AS WE UNDERSTAND IT (AND OUR UNDERSTANDING MAY BE INSUFFICIENT) THE US COMPANIES FEAR THAT THIS SORT OF VARIATION ON THE "VENEZUELAN MODEL" WOULD LEAD IRS TO CLAIM THAT THE FEE WAS NOT TRULY A SERVICE FEE, BUT A PRICE DISCOUNT ON WHICH THEY HAD NO RIGHT TO CLAIM CREDIT FOR IRANIAN TAXES.

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ACTION EB-03

INFO OCT-01 NEA-07 EUR-08 ISO-00 SS-14 INR-05 SP-02 H-01

L-01 PM-03 OES-02 PRS-01 SAM-01 /049 W

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R 120810Z MAR 76

FM AMEMBASSY TEHRAN

TO SECSTATE WASHDC 6007

INFO AMEMBASSY JIDDA

AMEMBASSY LONDON  
AMEMBASSY PARIS

C O N F I D E N T I A L SECTION 2 OF 2 TEHRAN 2579

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(B) THE OTHER ROUTE THEY MIGHT FOLLOW IS THE TRADITIONAL ONE:  
AN AGREEMENT THAT ESTABLISHES THAT THEY HAVE AN "ECONOMIC INTER-  
EST" IN IRAN FROM WHICH THEY EARN A PROFIT, ON WHICH THEY PAY  
IRANIAN TAXES, WHICH CAN THEN BE CREDITED AGAINST US INCOME TAXES.  
TO GENERATE A TAX CREDIT UNDER THIS SYSTEM, A LOCAL TRADING  
AFFILIATE OF EACH COMPANY MUST BUY CRUDE "AT THE WELL-HEAD"  
AT A LOW PRICE (ESSENTIALLY, AT PRESENT, OPERATING COST PLUS  
ROYALTIES PLUS BALANCING MARGIN) AND RESELL AT KHARG ISLAND  
(TO OTHER AFFILIATES OR TO THIRD PARTIES) AT A HIGHER PRICE, THUS  
GENERATING A CORPORATE PROFIT TAXABLE IN IRAN. SOME OF THE  
ELEMENTS THE US COMPANIES INSIST THEY MUST HAVE IN THE AGREE-  
MENT (IN ORDER TO PROVE TO IRS THAT THEY HAVE AN "ECONOMIC  
INTEREST") ARE RIGHT TO PURCHASE AT WELL-HEAD, ENTITLEMENT  
TO CAPACITY, AND A SPECIFIC GEOGRAPHIC AREA. TAX LAWYERS FROM  
DIFFERENT COMPANIES DISAGREE AS TO PRECISELY WHAT IS NEEDED.

5. FOREGOING ILLUSTRATES SKETCHILY THE KINDS OF PROBLEMS  
GOI AND MEMBERS ARE STRUGGLING WITH IN THE CURRENT NEGOTIATIONS.  
GOI, FOR POLITICAL REASONS, WANTS "SIMPLE AGREEMENT" WHICH  
THEY CAN PORTRAY AS NEW STEP IN PERFECTING THEIR CONTROL  
OF IRANIAN OIL. THEY WANT NOTHING IN THE AGREEMENT ABOUT  
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"ENTITLEMENT TO CAPACITY," FOR EXAMPLE, PREFERRING TO SELL  
A FIXED AMOUNT TO MEMBERS. EXPECTING AN UPTURN IN OIL DEMAND  
IN SECOND SEMESTER 1976, THEY FEEL THAT FROM LATE 1976 ON, NIOC  
ITSELF CAN SELL WHAT MEMBERS DID NOT GUARANTEE TO TAKE. NIOC  
HEAVILY OBJECTS TO "VENEZUELAN MODEL" PRINCIPLE OF FEE PER  
BARREL OR PRODUCTION (AS OPPOSED TO A FEE ON LIFTINGS) BECAUSE  
THEY EXPECT THAT DOMESTIC CONSUMPTION PLUS NIOC SALES WILL ACCOUNT  
FOR ALMOST HALF OF TOTAL PRODUCTION BY THE EARLY 1980'S. WHETHER  
THESE PROBLEMS CAN BE SOLVED AND A NEW AGREEMENT REACHED THAT  
MAINTAINS CONSORTIUM UNITY REMAINS UNCERTAIN. OUR PERCEPTION  
IS THAT US INTERESTS WILL BE BEST SERVED BY CONTINUED FULL PARTI-  
CIPATION IN CONSORTIUM OF US COMPANIES. CERTAINLY DECREASED  
ACCESS OF THESE COMPANIES TO IRANIAN CRUDE (AND CONSEQUENT IN-  
CREASED DEPENDENCE ON ARAB SUPPLIERS) WOULD CONSIDERABLY IMPAIR  
US COMPANIES' ABILITY TO HELP DEAL WITH ANY FUTURE EMBARGO.

6. EMBASSY WILL REPORT ANY FUTURE BRIEFINGS AS THEY OCCUR AND  
WILL SUGGEST COMPANIES GET IN TOUCH WITH DEPARTMENT ON THEIR

RETURN TO US.  
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